DOW THEORY LETTERS INC.

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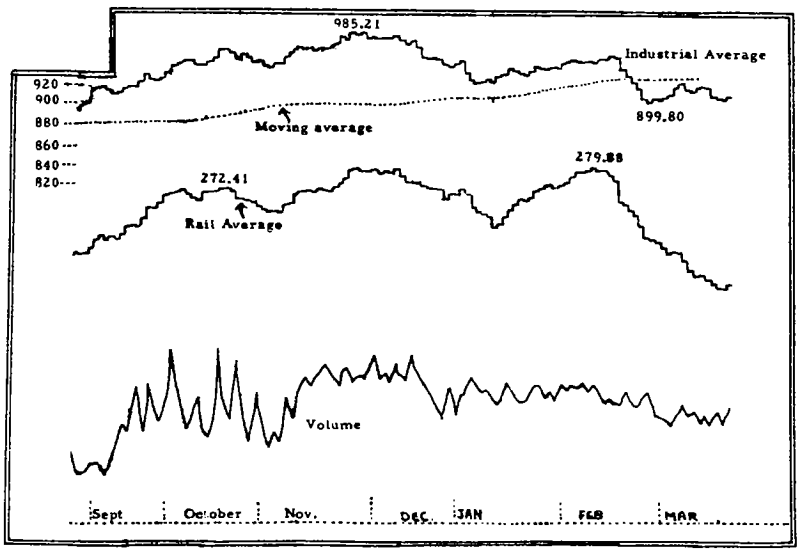
THE MARKET: On March 17, 1969, the prime rate at U.S. banks was boosted 1/2% to 7 1/2, the highest rate in history. This is the rate which the bank's prime or A-rated customers must pay to borrow money. It's a whopping level, and any businessman who plans to put 7 1/2% money to work must be pretty sure that he can produce big profits to cover this kind of interest rate. As the saying goes, at those prices it might pay one to lend rather than borrow. It all reminds me of the cartoon showing A Wall Streeter-husband looking at a tabulation slip included in his wife's bulging bag of super-market groceries. "At these prices," he shouts as he scans the slip, "you should have sold, not bought."

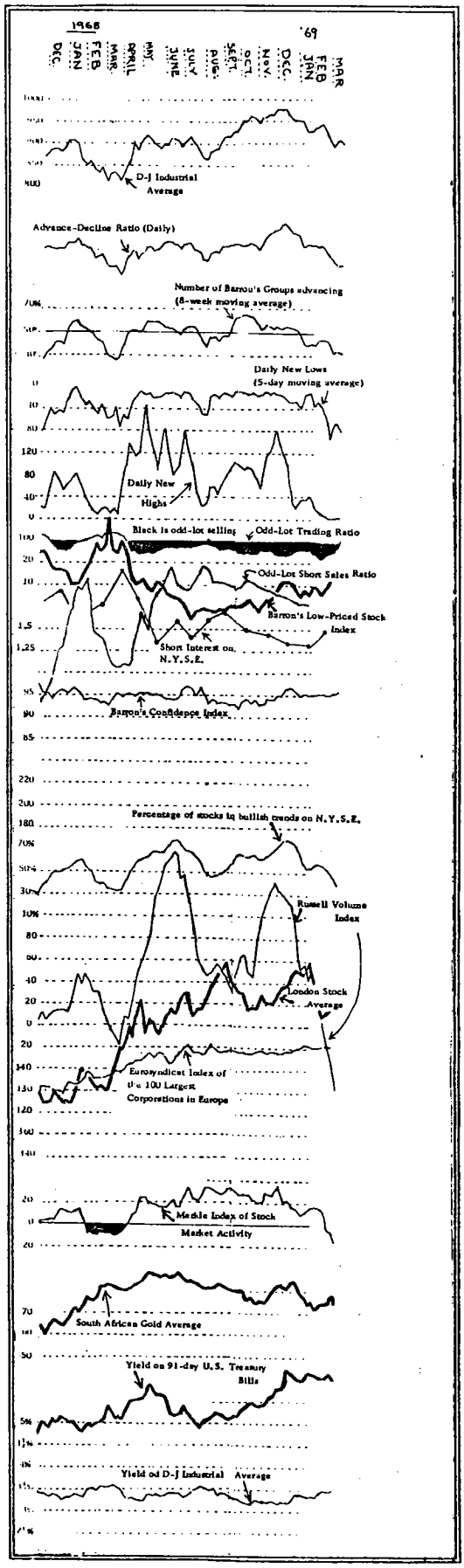
I have been reading dozens of reports on what is to be "expected" for the stock market in the months ahead. Many of these analyses are clever, many are intelligent, but almost all leave out two big factors: (1) the overall direction of the primary trend, and (2) mass psychology.

If one studies the history of the stock market one concludes that most of the major and secondary movements were "reasonable." Declines start generally when the market becomes overbought and overheated, advances begin when the market is oversold and overly pessimistic. On this basis, it would now be reasonable for an advance to begin. Most of the technical indicators are registering oversold, psychology is now somewhat sour on Wall Street, many speculative issues have collapsed. This is the reasonable time for a rally to start.

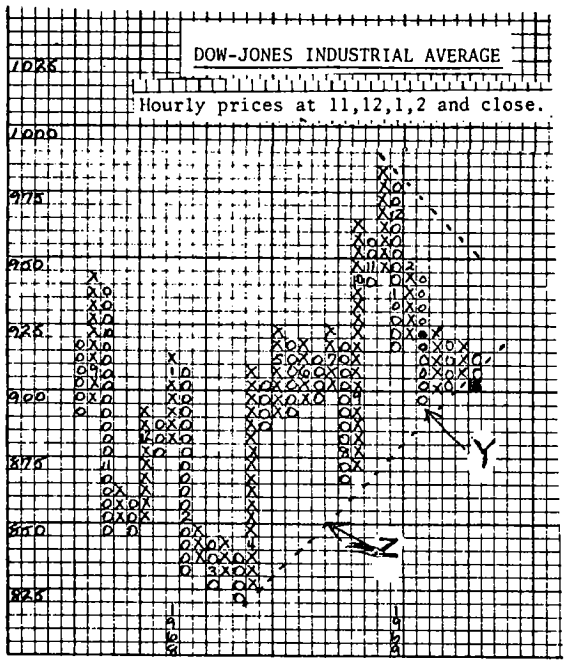
It should be remembered, however, that sooner or later primary bear markets get "unreasonable." They become vicious, they produce the unexpected, the unbelievable. At some stage bear markets no longer respect downside "support levels," they no longer respect trendlines and normal downside projections. That stage is still ahead.

The 900 level was widely forecast as a support level, and the next and even more widely-advertised support level is 870 on the Dow. In the weeks





and months ahead we will have a chance to see whether the bear market remains "reasonable" and respects those levels. I include a point-and-figure chart put out this week by Chartcraft (Larchmont, N.Y.), here we see a concentrated picture of the market. Each box represents 5 points on the Dow. The X's indicate rallies and the O's indicate declines. This is a 15-point reversal chart, which means that only those rallies or declines which consume 15 points or more are entered on the chart. For instance, a rally from 900 to 911 would not be shown on the chart. Only a rally from 900 to 915 would be entered since such a rally represents 15 points.



At the march 14 closing of 904.28 (black box on chart) the Dow broke below the rising trendline extending upwards from the 1968 bottom (trendline marked Z on chart). On a point-and-figure basis, the March 14 closing is a very bearish development in that it reverses a trendline which has held for over a year. A second bearish signal will be produced if the Dow touches 895 on an hourly basis. If this happens, the chart will produce a bearish penetration of the previous 900 bottom, which is marked Y on the chart.

With the "successful" testing of the 900 level on March 17 (last Monday), the stock market is now widely announced to be in a rallying phase. Almost everyone is caught up with the short-term picture or "what the market will do in the next few weeks." I continue to warn against this type of analysis. There seems to be something in man's nature which rebels against thinking in terms of major trends. The reason for this is that man insists on being master of his own fate, and the primary trend principle implies that there is something bigger than Governmental edicts, Congressional acts and the policies of the Federal Reserve Board. The concept that overall, Wall Street is in the grips of a primary bear market is simply unpalatable, and not five in a hundred investors can accept it.

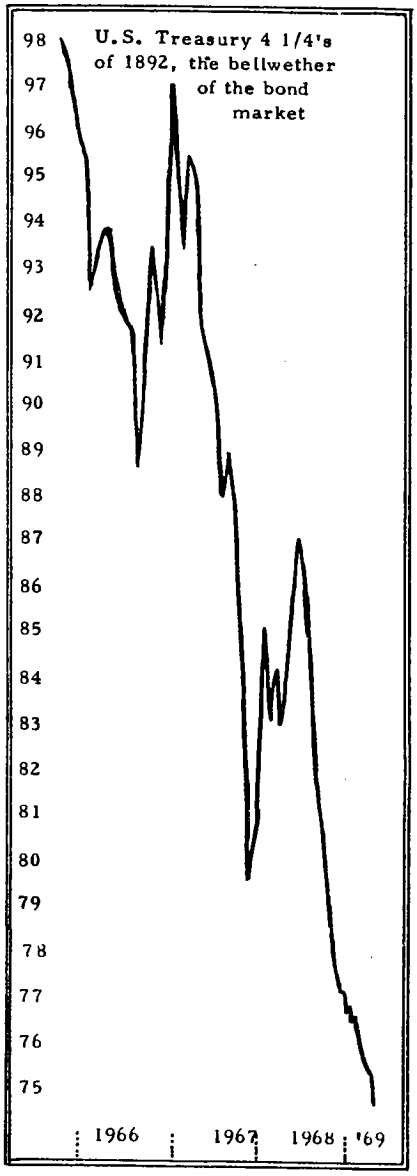
I could go on writing ad finitum regarding the inability of the Dow to get over its bull market peak (995.15) of three years ago, I could point to the fact that despite unprecedented inflation via inflation of the money supply and other vehicles, the market has never (following the 1966 highs) zoomed into the stratosphere as it might have been expected to. The reason for the resistance is that the primary bear forces have exerted steady pressure against the forces of inflation.

Ultimately, when least expected, the bear forces will come out for all to see. Then, despite Government intentions, despite the buying power of the funds, despite the fact that it is not reasonable, the market will crumble and crash and the true primary bear forces will emerge for all to see.

CONCLUSION: I continue to warn against investing against the primary trend. I warn against becoming optimistic as each rally corrects an oversold condition in the market. All history suggests that primary bear markets follow primary bull markets. By my analysis, we have been in a primary bear market since February 9, 1966, and sooner or later the moment of truth will be upon us. Why be exposed to a collapse? Why not let patience and knowledge override greed? Why not wait until the stock-bond relationship reverses, at a time when blue-chip and growth stocks are lulling about at high yields and at a time when bonds are once again popular and are selling at low yields? Few will have the foresight and patience to assume a long-term viewpoint towards investing, but those few are the ones who will come out ahead with profits, high-yields, income and good health. For the rest, I can only say that the anxiety, the ulcers, the sweating entailed in "beating" the primary trend is hardly worth the prize. But perhaps only hard experience can teach that lesson.

DEPRESSION IN BONDS: The collapse in the bond market continues to be breathtaking. Statistics and facts coming out almost daily present a picture that this generation has never seen before.

For instance, last week New York Telephone (a subsidiary of AT & T) offered a 40-year maturity bond at 7½% to yield 7.38% to investors. This was the greatest yield in the 73-year history of New York Telephone. The bond was offered to the public and the response was huge. Small customers withdrew money from savings accounts and flocked to buy the bonds in denominations of one, three and five thousand dollars. Said one bond dealer, "They came to us like Coxey's army from every direction; it was as though the widows, retirees and all other AT & T faithful were assembling for the company's annual meeting."



Ironically, the investment attitude toward the bond was entirely different. Large orders were singularly lacking, and by the end of the day only 30% of this fantastic bond was sold. With the bond market in collapse, it seems that no coupon, no quality, no terms will whet the appetite of big bond money.

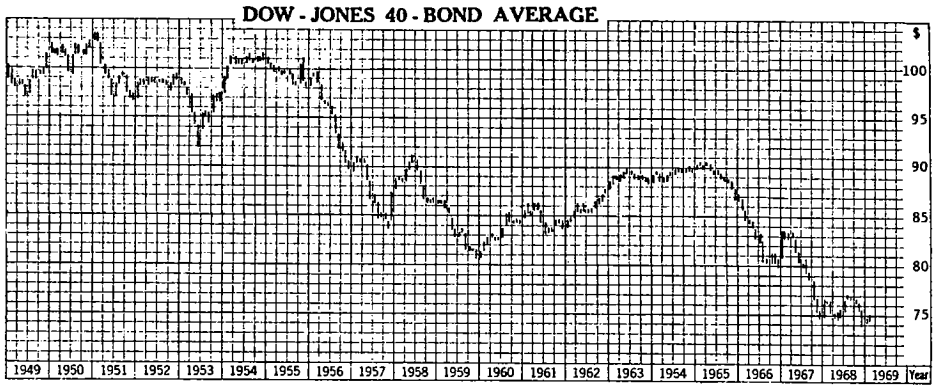
On March 18 the bellwether of the U.S. Government bond market, the 4¼ of 1987-92 cracked the 75 level to close at its lowest level since issuance (see chart). At a bid price of 74.20 (actually, $7,662.00) this leading Government bond sells to yield around 6.29%.

Again last week the yield index of (tax-exempt) municipal bonds rose to 5.25%, highest level since the Great Depression, at which time tax-exempts were less attractive due to the much lower income tax rates. The acceleration of the decline in municipals can be appreciated when it is realized that since last August, the D-J Index of municipals has dropped over 13%. In the past two weeks, the municipal index took one of its sharpest dives in its 40-year history.

At last week's price of 73.44, the D-J broad 40-Bond Average had dropped to its lowest price since 1933, and the average of 40 bonds was yielding 7.04%, about double the yield of the D-J Industrial Average. A chart of the 40-bond is included (chart courtesy of M.C. Horsey, Salisbury, Md. 21801).

Perhaps the best perspective on the whole bond picture is provided by the following from the March 11 Wall Street Journal: "Since mid-1965, the average price of all corporate, state and city and U.S. Treasury bonds has plummeted 25%—the sharpest drop ever—say bond historians. The decline has accentuated in recent months."

What does it all mean? It appears to me that the nation is slowly and surely moving into a debt crisis. Many states are now unable to sell bonds, due to restrictions on interest rates within the state. For instance, California has a 5% coupon limit, and recently called off $40 million in bonds. Florida last May offered a 4½% tax exempt bond which was withdrawn when not a single bid came from any dealer who was willing to attempt to merchandise the bond to the public.



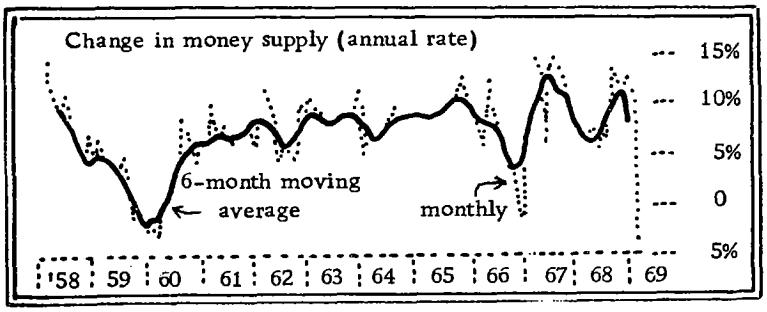
In general, the public does not realize the seriousness of the current bond depression. The bond market is far more important than the stock market as a vehicle for raising new money. Last year $34.6 billion in new money was raised through bonds, six times the amount that was raised through the sale of all new 1968 stock issues.

The fear of bonds is already driving debt-raisers into all sorts of new vehicles, including shorter-yielding bonds, bank loans, bonds with convertible features and warrants and commercial paper. But the fact remains that the collapse in bonds is a very serious phenomenon and besides cutting off one huge source of new funds, it is locking in investors and institutions with huge paper losses.

It is well to remember that only last summer investment experts were saying that the 10% surtax would end inflation, and that therefore, bonds were a once-in-a-lifetime bargain. They were a bargain, but they have become vastly more of a bargain since. Personally, I do not see the end of the bear market in bonds in terms of price, I see it in terms of time. I would guess that with the bond market in turmoil and the Fed committed to a policy of ending inflation, the bond market should hit bottom within the next year or so. I believe that if the stock market collapses

and business slows down, the pressure to raise new and currently-needed funds could put vast new pressures on the bond market. But either way, I feel that the bond market is entering its final downward throes, and that the long primary bear market in bonds since 1946 is within a year or so of reaching rock bottom.

MORE DILEMMA: As the accompanying news clip suggests, despite the wishes of the Administration and the Federal Reserve Board, business is continuing its expansion plans with a "we'll pay any price for money" attitude. This is bad news for those in the Government who want to slow or halt inflation, and it practically guarantees that money will



'69 Surge Expected In Capital Outlays

Dow Jones News Service

WASHINGTON — Businesses expect to sharply increase their plant and equipment outlays this year, according to a report issued yesterday by the Securities & Exchange Commission and the Commerce Department.

Outlays this year are expected to total $72.96 billion, a 13.9 per cent increase from the record $64.08 billion actual investment last year. The 1968 total was up 3.9 per cent from 1967.

While outlays in the fourth quarter of last year did not rise as strongly as expected, the report shows a sizable gain in the current quarter to a $71.65 billion seasonally adjusted annual rate. The 1968 fourth quarter rate was $65.9 billion.

ble than one released earlier this week by the Commerce Department after sampling a different group of businessmen.

RETAILERS OPTIMISTIC

Retailers project a 9 per cent sales rise this year and utilities expect a 7.3 per cent advance, the latest report shows.

The survey results reportedly are causing concern among Nixon administration and Federal Reserve Board officials who fear that many companies will be creating large amounts of excess capacity at a time when the government's restrictive fiscal and monetary policies are beginning to curb consumer demand.

Recently, Federal Reserve Chairman William McChesney

continue tight or tighter and that there will be no fundamental upside reversal in the bond market.

Keeping in mind that we now have the highest interest rates of the century, I have also included a little chart from the latest Business Conditions Digest put out by the Commerce Department. Here we see the sharp drop in the actual money supply. The money supply is shown on this chart as the percentage of change (annual rate) in total U.S. money supply (which includes demand deposits plus currency and commercial bank time deposits). The dotted line shows the monthly figures while the heavy solid line is a six month average of the monthly figures.

The last sustained downtrend in the solid line (six month average) terminated with the recession of 1960. If the current monthly figures continue in anything like the progression shown here, the six month average will continue down, and the results are almost surely going to lead to economic recession.

Therefore, the big question is— does the Fed mean what it says? Does the Fed have the fed have the guts to contract the money supply, thereby counteracting the forces of inflation? There is little doubt that if the money supply and interest rate situation keeps up, the stock market is going to be subject to a steady squeeze. The final question then, is whether the Fed will ease up if the stock market goes into a broad collapse? As they say, 1969 shapes up as an interesting year.

CONTRARY: Humphrey Neill (of "contrary opinion" fame) notes in his latest report that there are three generally accepted opinions on Wall Street today. (1) That the near-term stock picture is bearish, but that the long-term is bullish, (2) That business is in for continued good times, and (3) That the Federal Reserve Board is still kidding the public, and that it will not really put its dis-inflation policy into effect.

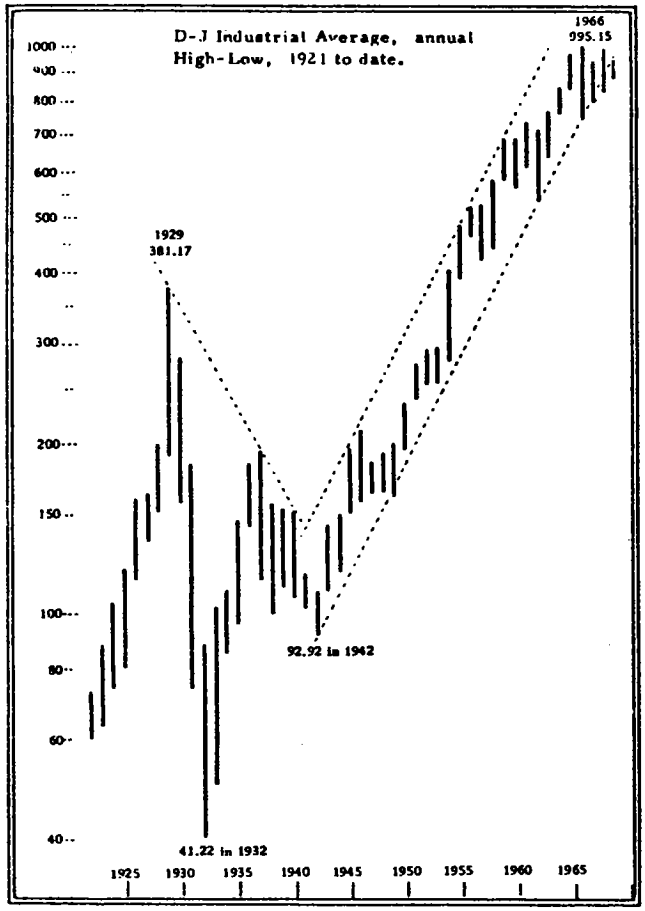
Taking a contrary view of these three opinions, we might say that the market is in for long-term trouble regardless of the near-term, that business is in for trouble in the period ahead (although the timing here is difficult) and that the Fed will keep the brakes on until inflation is halted.

Neill then comes to my favorite phenomenon, that of "crowd and market psychology." This, of course, is the great unknown. Let's face it, there isn't a man or a group of men alive who knows how the public and Wall Street will act if it turns out that inflation is really over. There isn't a man alive who knows what will happen if "confidence" in ever-increasing inflation suddenly turns to skepticism and pessimism. How much of the nation's business is conducted on the premise that things will get better and that nothing will occur to stem inflation? How many people hold shares on the premise that inflation will always bail them out of their mistakes, at which time they can sell their shares to the next sucker?

The fact is that the great majority of the nation is prepared for endless inflation, booming business and higher prices. They are not at all prepared for an end to inflation. Most of today's bears are really bulls (in that they own stocks) who are "thinking" bearishly. But thinking is no preparation, only acting is a preparation. And never have so many held stocks, never have so many held mortgaged businesses, mortgaged properties, and mortgaged mentalities. That

is why the situation is so dangerous. Not simply because the Government is insisting on stopping inflation. But because the Government is insisting on stopping inflation at a time when no one believes that the Government means it—and at a time when no one is prepared for an end to inflation.

YEARLY: The accompanying chart is one which I have included on a number of occasions in Dow Theory Letters. It shows the annual high-low range for the Dow, and as such it represents the longest-range picture of the trend of the Industrial Average.



As far as this chart is concerned, 1969 has already made big news. Note that from the famous 92.92 low of 1942, the Dow has climbed in a rising channel for 25 years through to the year 1967. Thus for a quarter of a century the Industrials have held within this amazing upward trend.

Then in 1968 (March 21), the Dow sold off sharply to 825.13. As seen on the chart, the 1968 decline broke slightly below the lower trendline of the channel. However, the strong and persistent rally which followed served to bring the Dow back within the channel again.

In a Letter written last last year, I called attention to the fact that in 1969 the lower channel line would intersect at about 950 for the Dow Industrials. Consequently, any decline by the Dow below the 950 zone in 1969 would represent the second successive year in which Industrials had failed to respect their quarter century rising channel.

On December 3, 1968, the Industrials topped out at 985.21, just 10 points under their historic 1966 bull market high. A violent decline ensued. By February 25, 1969, the Dow was down to a closing of 899.80. As seen on the annual chart, this break took the Industrial Average well below its channel line again.

As a rule, the longer the market trend, the greater the importance of a change in that trend. The year 1969 represents the second year in which the Dow has been able to honor the lower trendline of its great upward channel. I would say that a thorough and decisive reversal of the trend since 1962 should entail the Dow breaking below its 1968 low of 825.13. I believe that the chance of such a penetration is very good during 1969.

THOUGHTS FOR THE AGES: From the New York Times, March 11: "The Argus service is sold to institutional investors with the understanding that Argus is aiming for a minimum of 50% of capital appreciation in six months or 100% in a year. There is, of course, no guarantee of success."

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Prof. Robert Triffin at the Claremont, Calif. Conference last week: "We live under a system of mutual bluff today. The Europeans threaten to convert their dollar into gold, and we threaten to suspend gold payments if they do. Our only choice is whether to change the system by rational means or chaotically, and past history is not very reassuring on which it will be."

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From the March 15 London Economist: "The sustained market boom (in America) has bred a generation of young, arrogant gunslingers who have never seen a really wicked down market, and who do not even appear to believe that such a thing is possible.....The investment scene now is divided between the older, over-40 managers, who control funds larger than $500 million (who concentrate on the economically sound stocks of proven quality) and the post-1962 entrants to the market (who are not scared of high P/E's, operate very quickly, and above all do not like to hold cash).